

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: NOV 13 2000

Contact Person: [REDACTED]

ID Number: [REDACTED]

Telephone Number: [REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated under the laws of [REDACTED] on [REDACTED]. Your stated purpose is "supporting the development of freely-available computer software programs which implement core Internet protocols and standards."

You accomplish your purposes through a variety of activities including the hosting of software development efforts undertaken by others, distributing openly available software packages, supporting Internet software development discussion groups, providing support for the Internet infrastructure, and training and supporting the software users. You state that all of these activities are directed toward benefiting the public by maximizing the development, availability and use of publicly-available Internet software and serve the public interest of advancing the dissemination of scientific knowledge for improving the operation of the Internet which in turn advances the dissemination of information for educational, governmental and other uses.

Although you have taken on primary funding responsibility for developing a few core software programs, your board of directors recently decided to shift your focus to maximizing the distribution and maintenance of freely available Internet software packages developed primarily by others. You indicate that this shift was necessary to promote the public interest because for-profit organizations were not performing these services. Your programming work is performed by specialized programmers with particular expertise in network technologies, distributed name database administration, security, authentication and other Internet software areas. Your implementations of Internet software protocols are typically the first to occur and are often experimental. You state that you are not involved in the commercialization of any Internet software program.

You state that you serve as a clearinghouse and distributor of the source code for several open source Internet software packages by providing disk space and network access for software developers, notifying the public of available software programs, coordinating "bug" fixes, integrating fixes or additional program features that other programmers provide and improving the ability of the Internet software

[REDACTED]

researchers and programmers to make contact with others in the field. You indicate that in most cases, absent your hosting activities, these packages would have limited use and availability to the public because many of them were originally written by university students who are unable to distribute, support, or continue development after completing their projects or leaving their universities. The software is called "open source software" because it is publicly available, free of charge, to anyone who wants to use, modify, or redistribute it. You state that you provide these hosting services to the public free of charge.

You manage the Internet news group (bulletin board) [REDACTED] which also contains an archive of numerous openly developed Internet software packages. [REDACTED]

You receive no financial support for these management and coordination services and perform this work solely to support the Internet in general and open source code development specifically.

You use your expertise in domain name software to support the operation of a key component of the Internet infrastructure, the domain name "root" nameservers. You run one of the 13 domain name root nameservers, which provide the "top" of the domain name system and are referenced each time a domain name is translated into a network address. The root nameserver that you operate fields approximately 10% of all the translation requests sent to the root nameservers globally resulting in about 6,000 translation requests per second. The machines that provide this service were loaned to you and network connectivity has been donated. This domain name root nameserver service is provided by you to the public free of charge.

You fund the development and therefore own the intellectual property rights to three freely available "core" Internet-related software packages, [REDACTED], [REDACTED], and [REDACTED]. Although you will continue to develop and maintain these packages, as well as fund certain other software packages, direct funding of software development will be a smaller part of your operations in the future. You generally select your programming projects in conjunction with the [REDACTED] a largely volunteer organization whose mission is to standardize Internet related network protocol specifications. To develop these packages, you contract with outside software development firms and currently obtain much of your programming services from [REDACTED] pursuant to a Subcontract Agreement for software design, development and testing. Additional development is being done by [REDACTED] a contractor specializing in software testing and protocol conformance, and by [REDACTED] a contractor specializing in [REDACTED] implementation.

You offer technical support services in exchange for a "fee" (the "fee" exceeds the actual value of the services provided and thus contains a contribution element that supports your other activities). Subscribers to these services are generally entitled to get software "fixes" earlier than the general public, but have never been entitled to any development work that did not become part of the publicly available Internet software packages. Certain subscribers are entitled to appoint individuals to your technical advisory committee and to have their support of you acknowledged on your Web page by having you post a logo and provide a link to the subscribers' Web page. The technical support services are provided by [REDACTED] pursuant to a Subcontract Agreement.

You provide training in the use, management, and operation of the packages that you maintain. To date, you have offered both basic and advanced classes in [REDACTED] software packages and classes in the use and administration of [REDACTED]. There are plans to provide training in [REDACTED] as well as to provide customized training in other openly available Internet-related software packages maintained by you. Currently, either [REDACTED] or [REDACTED] pursuant to a Subcontract Agreement and Training Facilitation Agreement, provide the instructors for the training sessions. You state that [REDACTED] is unrelated to any of your officers or directors.

Upon request, you also add specific features to the Internet-related software packages that you maintain, but only when the work to be performed would add a new feature to the software that benefits the public. New features developed under the enhancement contracts are always incorporated into the publicly available software programs. The fee for specific contracts is determined on a case-by-case, cost recovery basis.

The "open source" software packages that you have funded are:

[REDACTED] is a system that enables humans to identify the location of another computer on the Internet using mnemonic words (e.g., [REDACTED] instead of numbers (e.g., [REDACTED]). Currently at version [REDACTED] active development of [REDACTED] was limited until you were formed with a grant from [REDACTED] since which time you have rewritten approximately 75% of the original code. [REDACTED] is openly and freely available with no restrictions on its use, modification or redistribution.

[REDACTED] is a suite of software programs designed to automate the assignment of IP addresses to ease administration of that resource. You have funded the development of this package from its inception and make it openly and freely available with essentially no restrictions on its use, modification or redistribution.

[REDACTED] is a suite of programs which implement a Network News Transfer Protocol ("NNTP") transmitter and receiver with associated administrative tools. Originally written in [REDACTED] was donated to you by the author when you were established. You have funded continued maintenance of [REDACTED] and make it openly and freely available with essentially no restrictions on its use, modification or redistribution.

Other "open source" software packages developed by others that you host include:

- | | |
|----------------|---|
| Vulture/rtrmon | A network management program |
| Cron | A tool that executes programs on a computer at arbitrary times |
| Rtty | A tool that allows a multi-user computer to manage multiple modems |
| NetBSD | A complete multi-user, multi-tasking operating system designed to run on virtually any computer system. |
| Xfree86 | An implementation of the MIT "X Windows" windowing system used on all Unix operating systems which is used to implement graphical applications such as user interfaces, CAD programs and games. |
| Sendmail | An electronic mail server which receives and sends electronic mail, acting like an electronic post office. |
| Lynx | A non-graphical, text based world wide web browser, particularly useful for the sight impaired. |

You pay rent inclusive of all utilities, telephone, cooling, and Internet connectivity, of \$[REDACTED] square

foot/month, which you indicate is substantially below market rate rent, to [REDACTED] pursuant to an oral agreement.

Your contract with [REDACTED] for training services contains provisions consistent with industry standards except that [REDACTED] is paid for training services only if the particular training program is profitable (a typical market-rate arrangement would include a guaranteed minimum or other fixed fee).

You do not employ computer programmers. Currently, you contract with [REDACTED] a for-profit corporation, for much of your programming services. [REDACTED] who is your Vice President, Secretary, Treasurer, Executive Director and a Director, is an employee of [REDACTED]. Both [REDACTED] and [REDACTED] who is your President, Chief Technical Officer and a Director, are shareholders and Directors of [REDACTED]. Your agreement with Internet Engines for programming services contains provisions consistent with industry standards except that you pay [REDACTED] at an hourly rate of \$ [REDACTED] which is well below current market hourly rates, which range from \$ [REDACTED] to \$ [REDACTED]. You also contract with [REDACTED] a sole proprietorship owned by Mr. Vixie, and various independent contractors for programming services.

You provide basic technical support for all of your programs in the form of web page announcements and updated versions of the hardware to the public free of charge. Users can, however, obtain higher levels of technical support in exchange for a fee. Full service agreements include maintenance and support for all of your programs, quarterly CD updates and documents, pre-release access to your packages and a priority on "bug" fixes and non-funded feature requests. Your level of services range from "standard" to "platinum" and the corresponding fees range from [REDACTED] to \$ [REDACTED]. These fees substantially exceed the fair market value of the services provided and thus include a contribution to support your general hosting and programming work (in most cases, approximately two-thirds of the fees represent a contribution). Enhancements produced under these service agreements are always incorporated into future releases of the publicly available software.

You provide both basic and an advanced two-day training course in your [REDACTED] software program for a fee of \$ [REDACTED] per student. In addition, you provide customized training on a case-by-case basis. The fee for customized training depends upon the location, the number of students and the degree of customization from the standard training. Your subcontractor will receive 90% of the net profits for each class taught.

A user who wants to get a specific feature programmed into the publicly available software can request that you enter into a Specific Enhancement Contract to perform the work. However, your web page advises that you will only agree to enter into a Specific Enhancement Contract if the request fits within your priority of adding new features to the publicly-available software. Your web page also warns users that because your development efforts involve the balancing of many priorities, you may not always be able to accommodate requests for Specific Enhancement Contracts. Fees for these services are determined on a case-by-case, cost recovery basis.

You indicate that your primary sources of income will be from generous sponsors, and from revenues from the sale of support contracts, training courses, consulting services and software development contracts.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations that are organized and operated exclusively for charitable or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subdivision, it is necessary for an organization to establish that it is not operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled by such private interests.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term educational relates to the instruction or training of the individual for the purpose of improving or developing his capabilities.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

Section 511(a)(1) of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c)(3).

Section 512(a)(1) of the Code defines the term "unrelated business income" as gross income derived by an organization from any unrelated trade or business regularly carried on by it, less deductions which are directly connected with the carrying on of such trade or business.

Section 513(a) of the Code provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organizations of its charitable, educational or other purpose or function constituting the basis of its exemption under section 501.

Section 1.513-1(b) of the regulations states, in part, that, for the purpose of section 513, the term "trade or business" generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes in the relevant sense, only where the conduct of business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income) and it is "substantially related", for the purposes of section 513 of the Code, only if the causal relationship is a substantial one. Thus, for the conduct of a trade or business from which a particular amount of gross income is derived to be substantially related to the purposes for which exemption is granted, the production or distribution of goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of goods or the performance of services does not derive from the conduct of related trade or business. Whether the activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

[REDACTED]

In Forrest Press, Inc. v. C.I.R., 22 T.C. 265, acq., 1954-2 C.B. 4, the Tax Court held that an organization which was organized to prepare and publishing a widely accepted system for indexing library collections was entitled to exemption under section 501(c)(3) of the Code of 1939, the predecessor of section 501(c)(3). The case establishes that library cataloging is in itself an activity which furthers education.

Rev. Rul. 81-29, 1981-1 C.B. 329, ruled on a library network which provided data business management software to libraries, some of which were not exempt, to permit the users to effectively search databases. The users paid a fee for the service. The service held that the organization advanced education within the meaning of IRC 501(c)(3). The fact that the information was provided to exempt and nonexempt users does not detract from the educational value of the information itself. This analysis applies to your proposed activities as the activities will facilitate the access to and use of your data to the public and to further your educational purposes. The proposed activities are an extension of your educational activities and thus are substantially related to your exempt purposes. (See Forest, supra, IRC 513(a) and the regulations thereunder).

Rev. Rul. 72-369, 1972-2 C.B. 245, provides that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code.

An organization is not operated exclusively for charitable purposes, and thus will not qualify for exemption under section 501(c)(3), if it has a single non-charitable purpose that is substantial in nature. This is true regardless of the number or importance of the organization's charitable purposes. Better Business Bureau v. United States, 326 U.S. 278 (1945); Stevens Bros. Foundation, Inc. v. Commissioner, 324 F.2d 633 (8th Cir. 1963), affg. 39 T.C. 93 (1962), Cert. denied, 376 U.S. 969 (1964); Operating for the benefit of private parties who are not members of a charitable class constitutes such a substantial nonexempt purpose. Old Dominion Box Co., Inc. v. United States, 477 F.2d 340 (4th Cir. 1973), cert. denied, 413 U.S. 910 (1973). See also, International Postgraduate Medical Foundation v. Commissioner, T.C.M. 1989-36, and Church By Mail, Inc. v. Commissioner, 765 F.2d 1387 (1987).

The private benefit prohibition of section 501(c)(3) of the code applies to all kinds of persons and groups, not just those "insiders" subject to the more strict inurement proscription. Prohibited private benefit may include an "advantage; profit; fruit; privilege; gain or interest." Retired Teachers Legal Defense Fund v. Commissioner, 78 T.C. 280, 286 (1982).

While some of your activities, such as providing access to free software, may further charitable, educational, or other exempt purposes we are unable to conclude that your activities, taken as a whole, exclusively further any exempt purpose.

Providing a portal to open source core Internet protocols is not per se an activity described in section 501(c)(3) of the Code. Such access to the software that you provide for free, some of which is developed by others, is already freely available to anyone with a computer presumably through any Internet service provider. You provide this service through your site but go beyond the free service to marketing support contracts for maintenance, training, consulting services and software development contracts. This activity distinguishes you from the organization discussed in Rev. Rul. 81-29, cited above.

You offer a wide range of support and service agreements for [REDACTED] and [REDACTED] servers, the protocols that you have traditionally funded. The highest priority on support services including "bug" fixes

[REDACTED]

goes to the customer with the most expensive service agreement (the Platinum Service Agreement sold for \$[REDACTED] annually). The level of services provided decreases as the service contract goes from Platinum to Gold (\$[REDACTED] annually) to Silver (\$[REDACTED]) to Bronze (\$[REDACTED]) and Standard, (\$[REDACTED] annually for each product and \$[REDACTED] annually for each product to be covered by a separate maintenance agreement. Your primary activity has become providing training, support, maintenance and other services related to your subcontractors' areas of expertise. Your methods of pricing and providing services are indistinguishable from ordinary commercial activity. This is a non-charitable purpose that is substantial in nature, and therefore precludes exemption under section 501(c)(3) of the Code. See Rev. Rul. 72-369, cited above.

Through your service contracts the majority of your revenues inure to the benefit of your officers and directors through subcontracts with companies in which your primary officers have ownership or control. There is nothing in section 501(c)(3) to prohibit all dealings between a charitable organization and its founder or with those in controlling positions. However, when the interests of charity are sacrificed to the private interests of the founder or of those in control, exemption is precluded because the organization is being made to serve private interests. See, International Postgraduate, and Church By Mail, both cited above.

Financial information submitted indicates that your major expenditure is for "outside programming services". The bulk of these services relating to [REDACTED] are performed by your Director, [REDACTED] who is also your landlord. Other services are provided by [REDACTED]. Both [REDACTED] your President, and [REDACTED] your Vice-President are shareholders and Directors of [REDACTED]. [REDACTED] is also owner of a sole proprietorship, [REDACTED] with whom you contract for programming services. The benefits of your services redound more to [REDACTED] and [REDACTED] than to the general public. This substantial private benefit outweighs any potential public benefit and thereby distinguishes you from the organization discussed in Rev. Rul. 81-29. This private benefit is a substantial nonexempt purpose and is therefore a bar to exemption pursuant to Better Business Bureau, cited above.

Because you maintain the intellectual property rights to [REDACTED] and [REDACTED] the basic versions which are freely available to all, you are the only provider uniquely in the position to provide the specific enhancements, including "bug" fixes, that may be requested by the public users of these products. You provide the basic free software through your Internet site in anticipation of the public making you aware of bugs in the product. Through the service contracts solicited from your subscribers, you then give the subscriber's bug report a priority based on the level of service contract purchased. You then subcontract for the services paying the subcontractor on a sliding scale from \$[REDACTED] for the Platinum Agreement to \$[REDACTED] for the Standard Agreement. For training related to the service contract, the fees for training, maximum number of attendees, venue, and materials, are set by mutual agreement between you and the subcontractor, with the subcontractor receiving 90% of the net profits for each class taught. Such a profit-sharing arrangement evidences a clear non-charitable purpose. These activities indicate that you are serving the private interests of your subcontractors in more than an insubstantial way. This substantial non-charitable purpose precludes exemption under section 501(c)(3) of the Code. See, Better Business Bureau v. United States and Old Dominion Box Co., Inc. v. United States, both cited above.

Because we believe that your primary activity of serving as a clearinghouse for your subcontractors' services is not an activity described in section 501(c)(3) of the Code, and because your activities result in substantial private benefit to your officers and directors through subcontracts with for-profit entities that they own or control, and also result in substantial private benefit to other unrelated for-profit subcontractors, and, because you have not otherwise established that you meet the requirements for exemption under section 501(c)(3), we have concluded that you are not operated exclusively for charitable, educational purposes and we therefore cannot recognize you as an organization exempt under that section.

You must file federal income tax returns. Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference. If you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
Attn: T:EO:RA:T:3 JC Rm. 6137
1111 Constitution Ave. N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Robert C Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3

Cc: [REDACTED]

	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
Code					
Surname					
Date					